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BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 95-862-C - ORDER NO. 95-1757

DECEMBER 29, 1995

IN RE: BellSouth Telecommunications, Inc. D/B/A Southern Bell Telephone and Telegraph Company - Investigation of Level of Earnings	))))	ORDER

This matter is before the Public Service Commission of South Carolina (hereinafter the "Commission") on the Commission Staff's (the "Staff's") investigation of the level of earnings of BellSouth Telecommunications, Inc. ("BellSouth" or "the Company"). Upon order by the Commission, Staff conducted an investigation of BellSouth's level of earnings for the year ending December 31, 1994.

In a letter to the Company, the Executive Director of the Commission instructed BellSouth to publish a prepared Notice of Filing in newspapers of general circulation in the affected areas one time. The Notice of Filing documented the nature of this proceeding and informed interested parties of the time and manner in which to intervene. BellSouth certified that it complied with the Executive Director's instructions. The Commission received Petitions to Intervene from the Consumer Advocate for the State of South Carolina (the "Consumer Advocate"), AT&T Communications of the Southern States, Inc. ("AT&T"), the South Carolina Cable

Television Association ("SCCTA"), MCI Telecommunications, Inc. ("MCI"), and the South Carolina Public Communications Association ("SCPCA").

On September 18, 1995, at 11:00 a.m., the Commission convened a hearing to address the Staff's investigation. The Honorable Rudolph Mitchell, Chairman, presided. F. David Butler, General Counsel, and Catherine D. Taylor, Staff Counsel, represented the Commission Staff. Harry M. Lightsey, III, Esquire, William F. Austin, Esquire, and R. Douglas Lackey, Esquire, represented BellSouth. Philip S. Porter, Esquire, and Elliott F. Elam, Jr., Esquire, represented the Consumer Advocate. Francis P. Mood, Esquire, and Roger A. Briney, Esquire, represented AT&T. B. Craig Collins, Esquire, and Mitchell M. Willoughby, Esquire, represented SCCTA. John M.S. Hoefer, Esquire, and Martha P. McMillin, Esquire, represented MCI. John F. Beach, Esquire, represented SCPCA.

The Commission heard testimony from numerous witnesses in this proceeding. I. Curtis Price, III, James M. McDaniel, and Dr. James E. Spearman testified on behalf of the Staff. The Consumer Advocate's testimony was presented by Philip E. Miller and Dr. John B. Legler. Dr. Legler was cosponsored by the SCCTA. G. Wayne Ellison, Mike Guedel, Timothy G. Knoblauch and Richard Guepe testified on behalf of AT&T. Clifton Craig testified on behalf of SCPCA. Dr. Randall S. Billingsley, Jerry D. Hendrix, Walter S. Reid and Joseph A. Stanley, Jr., testified on behalf of the Company. Two public witnesses testified.

After thorough consideration of the evidence presented at the hearing and the applicable law, the Commission makes the following finding of fact and conclusions of law:

FINDINGS OF FACT

1. BellSouth Telecommunications, Inc. D/B/A Southern Bell Telephone & Telegraph Company is a subsidiary of BellSouth Corporation. BellSouth's intrastate telephone operations are subject to this Commission's jurisdiction. South Carolina Code Annotated 58-9-10 to -2320 (1976).

2. BellSouth's currently approved rate of return on common equity is 13.00%. By Order No. 94-1229, the Commission set BellSouth's rates at a level so as to provide the Company with the opportunity to earn this return on common equity based on a test year ending December 31, 1992. *See*, Docket No. 93-503-C.

3. The Staff conducted an audit of BellSouth's operations for the period ending December 31, 1994. The Staff computed a rate of return on common equity of 17.48%, after accounting adjustments and *pro forma* adjustments. Rate of return on rate base after accounting and *pro forma* adjustments was computed to be 13.90%.

4. The Staff, the Company, and the intervenors proposed various accounting and *pro forma* adjustments to the Company's revenues, expenses, and investments as represented in BellSouth's surveillance report. Consistent with the Commission's desire to review the Company's earnings at December 31, 1994, the Commission will herein address the adjustments made by the parties.

A. Accounting and Pro Forma Adjustments

1. Revenue and Expense Items

a. Area Plus.

Both the Staff and Company have proposed adjustments to recognize losses related to the implementation of Area Plus Service. The Staff, in calculation of the adjustment, utilized data submitted by the Company in response to a Consumer Advocate Interrogatory. In that response, the Company reported "actual" monthly losses associated with Area Plus Service for November 1994 through June 1995. Staff utilized the data provided at that time to calculate the annual loss because the data was indicative of Area Plus Service's actual impact. However, during the hearing, cross-examination revealed that the information relied upon by Staff was a draft answer, and the final interrogatory response was different. The monthly losses submitted in the final interrogatory response are, in fact, estimated and not actual. Even so, for the reasons hereinafter elucidated, we believe that Staff's proposed adjustment is the appropriate one.

The Company proposed to include the financial results of Area Plus in the test year so as to reflect the going level results of the service. The Company calculated its adjustment by annualizing the June 1995 results.

The Consumer Advocate proposed that no losses should be permitted to be included in the rates to be established in this proceeding. The position is based upon the Stipulation of April 11, 1994, which stated that the Company would not request rate relief from the Commission for the implementation of Area Plus. AT&T agreed with the Consumer Advocate's position.

The Commission adopts Staff's adjustment which annualizes the January through June, 1995, results. The Commission finds that this calculation of losses accurately reflects the Company's earnings. In Docket No. 93-503-C, the Commission determined that an adjustment for Area Plus losses was appropriate. Here, BellSouth has not requested rate relief.

Previously, in support of its Alternative Regulation Plan, BellSouth submitted a surveillance report which calculated an adjustment using an estimated $15.4 million loss. The Commission determined in Order No. 94-1229 that the loss was credible but, until such time as the Company has some actual experience from Area Plus, losses should be shared equally by the ratepayers and shareholders.

BellSouth now has sufficient experience to calculate an appropriate adjustment. However, in such a calculation, estimates must be utilized. In order to determine the annual revenue loss resulting from Area Plus, assumptions involving the calling patterns of the customers subscribing to this service must be made. That is, in order to fully recognize the loss, an estimate of every Area Plus customer's calling habits must be accounted for. The Area Plus loss cannot be known unless the amount which BellSouth would have recovered but for Area Plus also is known. The amount which "would have been recovered" is ascertainable but is in part estimated. Once these assumptions are made, the actual revenue with and without Area Plus can be developed. We find that the total adjustment of $4,482,300 as delineated by Staff is appropriate, even though the adjustment is based in part on estimated data.

b. **Rate Decreases - Effect on Revenues**

Both the Staff and the Company propose to include the effects of a prospective rate decrease ordered by the Commission in Docket No. 93-503-C. Staff has proposed to reduce operating revenue by ($24,568,701) and the Company proposed an adjustment of ($24,568,441). The minimal difference may be attributed to rounding. The Consumer Advocate agreed with the Staff's adjustment. The Commission accepts Staff's adjustment as the most accurate.

c. **Termination of the Carrier Common Line ("CCL") charge.**

Staff, the Consumer Advocate and the Company made adjustments to reduce revenues to reflect the annual impact of the reduction of terminating carrier common line charge for local exchange companies ("LECs") which operate as intraLATA toll providers. During 1994, the LECs eliminated their intraLATA toll pooling arrangement. Most LECs chose to be access providers as opposed to being toll providers. Those LECs which elected to be toll providers were required to compensate the other LECs for termination of their intraLATA toll traffic.

Staff's proposed adjustment of ($534,919) reflects the revenue impact of the reduction in terminating carrier common line charge as required by Order No. 94-1229 for those minutes terminated on BellSouth network by these intraLATA toll providers. The Consumer Advocate agrees with Staff's adjustment.

The difference between the adjustment calculation of Staff and the Company is related to minutes of use in the calculation. The Company estimated its minutes of use for certain carriers. Staff, however, obtained the minutes of use for the same toll providers for three months during 1995 and annualized those minutes to calculate the adjustment in the same manner as the Company.

The Commission adopts the Staff's adjustment. The Commission concludes that Staff's methodology, which fairly reflects the Company's earnings, is calculated with known and measurable data.

d. Out-of-Period Credits

The Staff proposed to adjust the Company's 1994 revenues by $1,700,935 to reflect the 50/50 sharing with the interexchange carriers of the 1993 over-collection of originating carrier common line ("OCCL") revenues above the capped levels. This amount was provided as a bill-credit during 1994, and such an adjustment will remove the credit. The Consumer Advocate agrees with Staff's adjustment. The Company did not propose such an adjustment.

In Order No. 89-281, this Commission set forth a plan to reduce the OCCL charge over time by capping the intrastate OCCL charge revenues going forward. In Order No. 91-1156, this Commission modified the original plan which reduced the OCCL charges. The procedure set forth in that Order addressed excess revenues collected above the capped OCCL revenue level. This procedure required certain LECs to share or remit fifty percent (50%) of the over-collection with the interexchange carriers ("IXCs") by June 30 of the following year.

We adopt Staff's adjustment. Staff's adjustment is based upon known credits for 1994 and is calculated in accordance with sound accounting principles.

e. Carrier Common Line Origination Charges

The Staff proposed to decrease revenues of OCCL charges to reflect the change in the OCCL charges which became effective on January 1, 1995, pursuant to Order No. 89-281 (see discussion above). This reduction of revenues results in an adjustment of ($2,237,897). The Consumer Advocate agrees with Staff's adjustment. The Company suggests a slightly different adjustment which appears to be based on estimated 1995 demand.

We agree with Staff's adjustment, which is based upon 1994 actual demand and therefore provides a known and measurable standard to be utilized to properly account for the OCCL changes as required by the previous Order of this Commission.

f. Annualization of Special Assembly Tariffs

The Staff has proposed to annualize the contribution associated with the forty-five (45) Special Assembly tariffs between BellSouth and its subscribers which were approved by the Commission during the test year. Staff's adjustment is $283,280. The Consumer Advocate agrees with Staff's adjustment. The Company believes that customer growth, which brings in operating income to an end of period level by recognizing the growth in customers, already compensates for any earnings improvements associated with Special Assembly tariffs. Tr., Reid, Vol. 4 at 34.

The Commission concludes that this adjustment is consistent with treatment of this issue in prior Commission decisions and reflects the going forward contribution associated with these service arrangements.

g. Implementation of Extended Area Service

On July 17, 1995, the Commission issued Order No. 95-1366 in Docket No. 94-428-C requiring BellSouth and Sandhill Telephone Cooperative to implement Extended Area Service between the Camden Exchange and the Bethune Exchange. This adjustment recognizes BellSouth's losses due to implementation of this Extended Area Service. Staff's proposed revenue reduction is ($69,526). The Company proposed no adjustment.

The Commission adopts Staff's adjustment. The Commission finds that Staff's adjustment appropriately reflects the loss for the implementation of the EAS.

h. Royalty Adjustment

The Consumer Advocate proposed a royalty adjustment to increase revenues by two percent (2%) of the capitalization of BellSouth's unregulated operations. The Consumer Advocate supported its adjustment by stating that the unregulated operations of the Company and the BellSouth system as a whole benefit from their association with the Company and should bear a portion of the costs of maintaining the Company's reputation. The Consumer Advocate asserts that the Company's name and reputation have value and are in effect an asset to the Company. Tr., Miller, Vol. 3 at 85-90. The Company opposed this adjustment, saying that the Consumer Advocate's adjustment is unsupported by rationale or evidence. The Staff did not propose an adjustment.

The Commission denies the Consumer Advocate's proposed adjustment. The Commission believes it would be inappropriate to implement this adjustment without demonstrative evidence of benefit to the unregulated operations of BellSouth. We do not believe that the Consumer Advocate has shown such evidence here.

i. **Carrier Common Line End User Revenue Adjustment**

AT&T proposed the inclusion of an adjustment of interstate Carrier Common Line and end user revenues. AT&T asserted that BellSouth overrecovered through its interstate rates the revenue requirements in the amount of $2,086,000. Under FCC Separation rules, twenty-five percent (25%) of the costs of unseparated loop revenue requirements are assigned for interstate recovery, and the remaining revenue requirements (75%) are assigned for recovery through intrastate rates. AT&T stated that, due to the overrecovery, BellSouth, in effect, will be permitted to double recover these costs. The Staff did not propose such an adjustment.

The Company replied to this adjustment by stating that adoption of the adjustment would violate the jurisdictional regulatory process by accounting for interstate revenues, which are tariffed under the authority of the FCC, as if they were intrastate revenues tariffed by this Commission.

The Commission rejects the proposed adjustment. Adoption of the adjustment would improperly account for interstate funds as intrastate funds, and such action is beyond the jurisdictional purview of this Commission.

j. Universal Service Fund Revenues

AT&T also suggested an adjustment to include Universal Service Fund ("USF") interstate revenues in the test year. AT&T reasoned that the purpose of these federal payments is to keep local rates affordable and relieve BellSouth of some of its intrastate revenue requirements. The amount of BellSouth's 1994 payments from the USF were $11,941,000. AT&T further stated that FCC Rule Part 36(f) requires BellSouth to reduce interstate expenses by an amount equivalent to USF payments received. The Staff did not propose such an adjustment.

The Company answered this adjustment by proposing that the adjustment would attribute the revenues resulting from the USF recovery mechanism more than once and would violate Part 36 of the FCC Rules and Regulations.

Adoption of AT&T's proposal would result in both intrastate revenues and expense credits related to USF support being counted. The Commission declines to adopt AT&T's adjustment since the Company has already reduced intrastate expenses equal to the USF amount.

k. BellCore Dividends and Investment

Both Staff and Company proposed to include BellCore dividends as additional income for the test year in the amount of $177,685.

Additionally, both also proposed to include the net investment in BellCore in rate base as an adjustment of $1,359,811. This treatment is consistent with that of Order No. 87-466 issued in Docket No. 87-77-C.

The Consumer Advocate disagreed with both treatments and stated that the Staff and Company proposals should be rejected. The Consumer Advocate reasoned that such procedures are no longer necessary. The inclusion of the BellCore dividends and investment was begun in Docket No. 87-77-C when BellSouth petitioned for, and was granted, approval for transfer of assets to BellSouth Services, Inc. ("BSS"). At that time, the Commission also approved the inclusion of dividends received from BSS in operating income and the investment in BSS in rate base. At that time, BSS received dividends from BellCore which, in turn, were included in the dividends issued by BSS to BellSouth. The Consumer Advocate suggests the elimination of this adjustment since BSS no longer exists. The Staff and Company support the continuance of the recommended adjustments since dividends received include earnings arising from BellCore dividends. We agree with the Staff and Company view and adopt their adjustment, including the inclusion of net investment in rate base.

1. Net Write-offs of Uncollectibles

The Consumer Advocate proposed to increase revenues for net write-offs of uncollectibles in the amount of $1,199,000. The Consumer Advocate stated that, based upon the Company's answer to an interrogatory, the Company calculated test year uncollectible revenues upon the recognition of an allowance for anticipated uncollectible revenues. The Consumer Advocate suggested that uncollectible revenues should be based upon the actual uncollectible revenues realized during the test year unless such amount is abnormally high or low. Neither Company nor Staff proposed such an adjustment.

The Commission denies the Consumer Advocate's adjustment. The Commission believes that Staff's treatment of this item is appropriate and follows proper accounting and regulatory procedure.

m. Effect of BAPCO

The Staff and Company both propose to increase revenue for the effect of the net income of BellSouth Advertising and Publishing Company ("BAPCO"), a separate subsidiary which handles the yellow pages operations. In Docket No. 83-414-C, the Commission determined that the net income of BAPCO should be recognized as operating revenues and that the investment should be reflected in rate base. The Staff's and the Company's adjustments increase operating income by $6,031,000.

The Consumer Advocate asserted that the proposed adjustment to operating income is understated because the test year's income is abnormally low due to certain non-recurring accounting adjustments which occurred in December 1994.

The Commission adopts Staff's adjustment. The Commission feels that Staff's adjustment is the most accurate adjustment and relies upon known and measurable data.

n. Pioneer Club

The Staff proposed to disallow the Company's $119,203 in expenses associated with its Pioneer Club on the basis that the Pioneer Club is not necessary for the provision of telephone service. The Company proposed to adjust the expenses by ($117,087).

The Pioneer Club is an association of current and retired BellSouth employees whose volunteer activities are aimed at providing service to the community and building the skills and morale of the employees involved.

The Commission concludes that, although improvement of employee morale and skills through volunteer community activity may in some fashion benefit the ratepayer, ratepayers should not be required to fund the expenses of the Pioneer Club. The Commission adopts Staff's adjustment.

o. Flowback of Excess Unprotected Deferred Taxes and Related Income Tax Expense

The Staff and the Company both have proposed to flowback excess deferred accumulated income taxes ("ADIT") over a five year amortization period. The Company overaccrued the flowback during the test year, and therefore Staff suggests returning to the ratepayer that portion of ADIT which is not required by law to be "flowed back" ratably over the life of the assets themselves. The Commission, in Order No. 94-1229, required this return over a five year period. We think that the same principle applies in the present case, in that an adjustment is needed to correct the

Company's overaccrual of return during the test year. The amount of the increase to operating taxes is $60,221, and the Company agrees with Staff's adjustment. The corresponding adjustment to rate base, as suggested by Staff and the Company, is ($60,221).

The Consumer Advocate, however, proposed that the Staff and the Company erred in calculation of the amount of the adjustment. The Consumer Advocate stated that the amortization should not be reconciled against the annual amortization for ratemaking purposes. Although in agreement with the concept of amortizing ADIT over a five year period, the Consumer Advocate contends that Staff reduced net amortization by the amount of $215,616, creating an increase in taxes of $60,221. The Consumer Advocate's suggested adjustment is ($155,395).

The Commission adopts Staff's adjustment. The Staff made the reduction since the amortization was made during the test year, and, therefore, it must be reconciled against the annual amortization for ratemaking purposes. The Staff's adjustment is in accordance with past rulings of the Commission and, through appropriate accounting procedure, accurately corrects the Company's 1994 overaccrual of the return.

p. Nonallowables

The Staff proposed to eliminate expenses that have traditionally been considered nonallowable for ratemaking purposes. Generally, the Staff disallowed these expenses because they were considered unnecessary for the provision of telephone services. The Staff adjustment reduced the Company's operating expenses by ($1,342,078). Specifically, the items disallowed included Employee newsletters and bulletins, Employee gifts and awards, membership dues and fees, and image building advertisements. The Consumer Advocate agreed with Staff's adjustment. The Company suggested a slightly different adjustment of ($1,095,880).

The Commission adopts Staff's adjustment. The Commission finds that the Staff appropriately disallowed items which are not necessary for the provision of telephone service, and, therefore, should not be ratepayer expenses.

q. Environmental Cleanup Costs

The Staff proposed to true up the liability of environmental clean up costs based on the amortization of the actual liability for the test year. The adjustment is based on the liability established in Docket No. 93-503-C which is to be amortized over a five year period. This amount increases operating expenses by $241,109. The Company accepted Staff's adjustment.

The Consumer Advocate agreed that a true-up is required but that the true-up should reconcile the actual liability with the costs which have been recovered through rates.

The Commission adopts Staff's adjustment. The Commission concludes that the true-up is appropriate and recognizes sound and accepted accounting principles. This true-up complies with Order No. 94-1229, which found the five year amortization period to be fair and reasonable.

r. Annalization of Salary and Wage Expenses

The Staff proposed to annualize salaries and wages by annualizing the effect of wage increases granted during the test year. Staff has suggested that because of corporate reorganization, technological advances, and the present trend of "downsizing," such a calculation fails to consider significant reductions in employees. Staff proposes to utilize the latest available, known data. Therefore, Staff has annualized the three month period of March through May 1995 in order to capture employee reductions and has arrived at a reduction of $4,852,001, in salaries and $357,922 in related payroll taxes. The Company, however, proposed to annualize wage increases given during the test year.

The Consumer Advocate agreed that test year wages needed adjustment in order to account for the reduction in work force which occurred subsequent to the end of the test year. However, the Consumer Advocate suggested that the wage adjustment should be based upon the actual data for the months of May and June, 1995. The Consumer Advocate stated that this methodology would more fully capture the work force reduction expected to occur through the end of 1996.

The Commission adopts Staff's salary and wage adjustment. The Commission finds that this adjustment fairly reflects the Company's salary and wage expense while accounting for employee reductions.

s. <u>Non-Allowable Lobbying</u>

The Company proposes to remove from cost of service the amount the Commission found unallowable in Order No. 94-1229 in Docket No. 93-503-C for lobbying and associated legal fees. The Staff proposes to reduce these costs by the relative percentage, derived from the previous docket, applied to above-the-line account balances for the test year. The Company's recommended adjustment is ($113,260), while the Staff's is ($34,036). Both recommend an appropriate adjustment to operating taxes. The Commission believes that Staff's adjustment is the more logical one, and therefore adopts Staff's adjustment.

t. <u>Out of Period Expenses</u>

Both the Company and the Staff propose to eliminate out-of-period income and expenses. The Company recommends an adjustment of $121,974, while Staff supports an adjustment of $116,446. Both recommend an appropriate adjustment to operating revenue and operating taxes. The Commission adopts Staff's adjustment, since it was developed based on the latest available data.

u. <u>FASB 106 (OPEB) Costs</u>

The Consumer Advocate has recommended an adjustment of ($1,185,000) to reduce FASB 106 (OPEB) costs to the 1995 level. No other party has made such a recommendation.

It is the Consumer Advocate's position that the test year FASB 106 costs are abnormally high, and in addition, are not reflective of the costs currently being incurred by the Company.

The Company is a subsidiary of the BellSouth Corporation. Thus, certain costs, including the FASB 106 costs, are set at the consolidated level and then allocated or assigned to the Company. BellSouth's annual FASB 106 costs are based upon actuarial studies.

According to Consumer Advocate witness Miller, the costs for any particular year are actually based upon the valuation performed as of December 31 in the preceding year. For example, the 1994 net periodic retirement costs are calculated at the beginning of the year in connection with the 1993 valuation, and similarly the 1995 costs are based upon the 1994 valuation. In each actuarial report, the actuary, among other things, provides the final net period postretirement benefit cost for the previous fiscal year as well as the initial cost for the current fiscal year. For example, in the 1995 actuarial report, the actuary provided the final net periodic postretirement cost for the fiscal year beginning January 1, 1994, and the initial net periodic postretirement benefit cost for the fiscal year beginning 1995. Following are a comparison of the actual FASB 106 costs determined by the actuary for 1993, the first year in which FASB 106 was applicable, 1994, and 1995:

1993	$263,266,000
1994	296,692,000
1995	269,603,000

According to Miller, the 1994 test year costs are abnormally high. Since, in his opinion, the 1994 actual costs are extraordinary in nature, Miller believes that an adjustment is in order. Moreover, according to Miller, an adjustment is in order so that the test year will be based upon the latest known and measurable costs. Tr., Miller, Vol. 3 at 77-82.

The Company took the position that the 1994 FASB 106 costs were not abnormally high, and that it believes that the discount rates are going to decrease thereby increasing the FASB 106 costs. Tr., Miller, Vol. 4 at 259-260. According to Miller, the comparison of the numbers show that the 1994 costs were abnormal. Further, Mr. Miller presented evidence that the discount rates which were used to determine the 1994 FASB 106 costs were based upon the lowest interest rates in a twenty year period. Tr., Miller, Vol. 3 at 77-82 and Tr., Miller, Vol. 6 at 107-108.

The Consumer Advocate also asserts that the Commission has consistently based costs such as this on the ongoing expenses of the utility. For example, in the most recent earnings review proceeding, the Commission based the Company's pension expense upon the expense being incurred during the next calendar year because it was based upon the ongoing expenses of the Company. Order No. 94-1229 at 5. Not only is the recognition of the latest known FASB 106 costs consistent with Commission precedent, according to Miller, but in addition, is consistent with the proposed treatment of salaries and wages. The Company's test year FASB 106 costs should be reduced by $1,185,000, according to Miller. Hearing Exhibit 17, Schedule PEM 3.7.

We have reviewed the testimony and Briefs of all parties who commented on this issue, and we agree with the Consumer Advocate.

We concur that 1994 test year costs are abnormally high, and we believe that the Consumer Advocate's recommended adjustment is appropriate, and therefore adopt it, for the reasons stated by the Consumer Advocate.

v. Non-Allowables

Both the Staff and the Company propose to remove contributions and sponsorships allocated to the Company from BellSouth and BellCore. The Staff recommends an adjustment of ($145,400), while the Company recommends an adjustment of ($142,786). Both recommend an appropriate complimentary adjustment to customer operations and to operating taxes. We hold that the Staff adjustment more appropriately takes into account the proper level of removal of these nonallowable expenses, and, therefore, we adopt said adjustment.

w. FAS 112 Costs

Both the Staff and the Company propose to amortize the catch-up entry associated with FAS 112, Employers' Accounting for Postemployment Benefits, over five years. The Staff proposes an adjustment of $1,117,135 and the Company an adjustment of $2,792,838. Both propose an appropriate adjustment to operating taxes. According to the testimony of Staff witness Price, Staff's proposed adjustment is based on the latest available data. For this reason, we adopt Staff's adjustment.

x. Reorganization Costs and Consultant Fees

BellSouth proposes to amortize consultant fees incurred during the last docket over a three year period, and to recover all other reorganization costs as they are incurred. Staff proposes to amortize all reorganizational (downsizing) costs over a three year period. These are costs incurred through May 1995. The Company's proposed adjustment is $152,667, while Staff's proposed adjustment is ($9,359,074). Both Company and Staff propose appropriate adjustments to other accounts, based on their primary adjustments.

The Consumer Advocate agrees that a normalization adjustment is in order, but believes that reorganization costs should be amortized over a five year period, and an adjustment of ($13,972,110) should be made.

The Company asserts in its brief, as per the testimony of Walter Reid, that the regulatory practice of deferring the future expenses which would otherwise be recovered by competitive firms in the current period is becoming more impractical. Therefore, Reid proposes to recover reorganization costs as they are incurred.

We are unprepared to hold at this juncture that BellSouth operates in a competitive environment. However, in recognition of at least a trend in that direction, we hold that the Company must amortize reorganizational expenses over a two year period, except for consultant fees. With regard to consultant fees, we agree with Staff and the Company that a three year amortization period is appropriate. We therefore hold that an adjustment of ($2,408,211) is appropriate.

y. Asbestos Removal Costs

Both the Company and the Staff propose to amortize the costs of asbestos removal over five years. The Company proposes to continue the amortization of the same dollar amounts contained in Order No. 94-1229, pertaining to Docket No. 93-503-C. Staff proposes to include additional amounts, contained within the test year, along with amortization of previous amounts. The Company's proposed adjustment is $15,298, while Staff's adjustment is $19,030. We hold that the Staff adjustment is appropriate, since it properly includes amounts contained in the test year that were not present in previous dockets.

z. **Customer Growth**

Every accounting witness agreed that a customer growth adjustment is appropriate and should be made in this proceeding. However, the Company, the Staff and the Consumer Advocate each utilized different approaches for calculating the customer growth adjustment. Hence, each presented a different amount for this adjustment. (Testimony of Reid, Tr., Vol. 4, p. 223, ll. 5-6; 257, ll. 6-13).

The purpose of the customer growth adjustment, as pointed out by Company witness Reid, is simply to adjust the test year net operating income to a level that is appropriate for use with the end of period rate base. The standard methodology is simply to determine the percent increase in the end of period access lines in service and then to compare that number to the average access lines in service for the test year 1994. This percent increase (i.e., growth in customer base) is then applied to the test period net operating income in order to determine the appropriate adjustment to bring net operating income to an end of period value.

The Company utilized this standard methodology in calculating its adjustment, while the Staff and the Consumer Advocate both used alternate methodologies. (Tr., Vol. 4, p. 223, ll. 5-9; p. 257, ll. 6-13). The Staff included the number of access lines through May 1995 in computing the percent increase. (Tr., Vol. 1, p. 135, ll. 10-11). The Consumer Advocate's witness, Mr. Miller likewise measured consumer growth by calculating the number of access lines as of May 31, 1995. Mr. Miller then compared this amount of access lines to the average growth, as opposed to the actual growth percentage for the test year. (Tr., Vol. 3, p. 93, ll. 9-13).

The Company advocated a growth rate of 1.61%, while the Staff proposed a rate of 2.89%. The Consumer Advocate recommended a 3.90% growth rate. We have examined all three methodologies, and conclude that Staff's is the most appropriate for use in this case, for the reasons stated hereinafter. We hereby adopt Staff's adjustment of 2.89%.

The Commission should consider post-test year data that is known and measurable. See Southern Bell v. Public Service Commission, 270 S.C. 590, 244 S.E.2d 278 (1978). We believe that data up to and including May 31, 1995 is known and measurable in the present proceeding, and gives us a better and more accurate evaluation than either the Company's or the Consumer Advocate's adjustment. The Company's adjustment ignores known and measurable post-test year data. The Consumer Advocate's adjustment was rejected by us in Order No. 94-1229 "because the average customers used in this approach constitutes an inconsistent use of the customer growth formula." See Order No. 94-1229 at 22. We have not changed our mind with regard to the Consumer Advocate's adjustment in the present proceeding. We think the same reasoning applies.

We therefore adopt the Staff's methodology and its adjustment.

aa. Interest Synchronization

The Company and the Staff both propose to increase income taxes for interest synchronization, based on capital structure, embedded cost rates, and the rate base approved in this Order. The Company recommends an adjustment of $229,292, while the Staff recommends one of $275,286. Staff's recommendation is derived by updating the capital structure and embedded cost of debt, and is the more appropriate adjustment. We therefore adopt Staff's adjustment.

bb. Sale of BellBoy Paging Service

During 1994, the Company requested from, and received, permission from the Commission to discontinue its Bellboy Paging Service. Therefore, it was necessary in this proceeding to eliminate the revenues, expenses, and investment from the cost of service in this proceeding. The Staff and Company have proposed eliminating the test year revenue and expenses, and the remaining portion of the investment which had not already been removed as of the end of the test year. The Consumer Advocate agrees with these proposed adjustments in principle. We adopt Staff's adjustment of ($193,795) to decrease revenues, and ($233,006) to decrease expenses as they are based on more current data than the Company's, and are more appropriate than the Consumer Advocate's.

All three parties propose an adjustment to decrease expenses for the gain on the sale of the BellBoy lines of business. The Company and Staff propose an adjustment of ($718,863), while the Consumer Advocate proposes an adjustment of ($915,463). The Consumer Advocate's proposed adjustment includes a gain on the sale of $196,600. We find that Company and Staff adjustment is more appropriate and should be adopted. We hold that the Company and Staff adjustment eliminates only Account 7370 costs. An adjustment for the higher figure proposed by the Consumer Advocate is simply unnecessary.

cc. Interest During Construction

The Staff proposed to show the effect on Interest During Construction ("IDC") of reclassifying short-term Telephone Plant Under Construction ("PUC") projects to long-term after the end of the test year. Staff proposes a $131,700 adjustment. We believe that this adjustment is consistent with good accounting and regulatory practice, and adopt the adjustment.

dd. Annualization of Interest on Customer Deposits

The Commission Staff proposes an annualization of interest on customer deposits. This adjustment is ($31,097). We believe that this adjustment is consistent with good accounting and regulatory practice, and adopt same.

ee. Officer Pay Increases

Staff proposes to remove officer pay increases and incentive compensation payments from test year expenses, and proposes an adjustment of ($294,064), along with an appropriate adjustment to operating taxes. Staff witness Curtis Price testified that increases in officers' compensation can be non-recurring, depending not only on evaluations of individual officers, but upon the financial performance of the Company. According to Price, such compensation is therefore best shared between ratepayers and stockholders, the latter being the primary beneficiaries of officers' performances. Price states his belief that removing increases during the test year accomplishes this objective. We are persuaded by witness Price's assertions, and approve the Staff's adjustment, based on Price's reasoning.

ff. Non-Allowable Items

The Staff proposes to remove non-allowable items allocated from BellSouth Corporation which were booked above the line by the Company. These items were based on Staff's previous audit of BellSouth Corporation and are in addition to items removed by the Company in previous adjustments. Staff recommends an adjustment of ($71,575). The Commission holds that this adjustment is consistent with sound accounting and regulatory principles, and therefore adopts same.

gg. Removal of Debit Balance

During the course of Staff's audit, Staff discovered a large debit to accumulated depreciation. This debit resulted from the retirement of large quantities of obsolete switching equipment. The Staff proposes to remove a debit balance from the depreciation reserve for analog switching equipment. Staff proposes a three year amortization of the debit balance, and an adjustment of $3,419,498. The Company and the Consumer Advocate agree with the adjustment. Staff's solution is appropriate and the Commission approves same.

hh. Expenses of Previous Case

The Staff proposes to amortize the expenses associated with the Company's previous case, Docket No. 93-503-C over three years. This adjustment is ($101,833), and is consistent with good accounting and regulatory principles. The Commission therefore adopts the adjustment.

ii. Refinancing Costs

As in Docket No. 93-503-C, the Company proposes to recover the expenses associated with refinancing debt at the same rate as interest savings benefit ratepayers. The Company's adjustment reduces net operating income by $3,567,966 and increases rate base by $3,230,133. The Staff proposes denial of the inclusion of refinancing costs as a cost of service item, but amortizing the costs over the term of the new debt, and adding $5,322,286 to rate base. The Company proposes to match costs with interest savings until offset, which is an approximate 2.5 year period. The

Consumer Advocate proposes a 10 year amortization period, but opposes addition to the rate base.

In Docket No. 93-503-C, Order No. 94-1229, this Commission adopted Staff's adjustments for refinancing costs. The Commission held that those adjustments would encourage Southern Bell to seek out debt with lower interest rates, thereby lowering its embedded cost of debt over time, and benefiting both the shareholders and the ratepayers.

We believe that the same reasoning applies in the present case, and we once again adopt Staff's adjustments for refinancing costs. First, the Commission finds it appropriate to amortize the refinancing costs over the time in which the new debt issues are outstanding. The Commission does not believe that it is appropriate for the utility to fully recover this cost above the line as an expense item. Second, the Commission concludes it is appropriate to allow the utility a return on the money its shareholders invested to acquire lower debt costs. The Commission believes the accounting method adopted herein will encourage Southern Bell to seek out debt with lower interest rates, thereby lowering its embedded cost of debt over time, and benefiting both the shareholders and the ratepayers. The benefits of a lower debt cost are apparent in this proceeding as they were in Docket No. 93-503-C. The Consumer Advocate's argument to the contrary, this method does not allow Southern Bell to overrecover its costs, but it does allow the Company to earn a return on its investment in refinancing costs.

Rate Base Items

a. Inclusion in Rate Base of Unamortized Refinancing Costs

Both Staff and Company propose inclusion of unamortized refinancing costs in rate base. Staff proposes increasing rate base by $5,322,286 and the Company by $3,230,133. This treatment is consistent with that seen in the last earnings review Docket No. 93-503-C, and the Commission holds that similar treatment is reasonable in the present case. Rate base treatment of the unamortized balance along with amortization of the cost of debt refinancing over the term of the new debt allows the Company to recover its costs and encourages refinancing of debt, according to Staff witness Price. The Commission agrees with Staff's reasoning, and adopts Staff's inclusion in rate base of the Company's unamortized refinancing costs. Rate base is hereby increased by $5,322,286 accordingly.

b. Removal of Debit in the Depreciation Reserve

Staff, Company, and the Consumer Advocate all recommend lowering rate base to remove debt balances in the depreciation reserve account related to analog switching equipment. Since this equipment is no longer in service, it is logical to remove the debit balance from rate base. We adopt Staff's adjustment, as it is complimentary to our approval of Staff's three year amortization of the debit balance.

c. Cash Working Capital Allowance

Both Staff and the Company propose a cash working capital allowance of $2,046,511, which is based on using average daily cash balances. This method has long been used by the Commission in determining the Company's cash working capital allowance. The Consumer Advocate proposes an allowance of $0, based on its contention that this Commission should recognize the negative cash working capital allowance indicated by the Company's lead-lag study.

We see no reason to deviate from our prior methodology in this area. The average daily cash balance method has been used historically by this Commission as a true and accurate measure of cash working capital requirements, and we believe it to be equally true and accurate in the present case. We therefore adopt Staff's and Company's allowance.

d. Other Rate Base Items

The Commission notes that many revenues and expense adjustments addressed earlier in this Order have a corresponding affect on Southern Bell's rate base. The Commission has not specifically addressed the rate base treatment of proposed adjustments it has previously discussed.

e. Miscellaneous Adjustments and Taxes

All other adjustments agreed to by the parties and not specifically addressed herein are approved. All other adjustments proposed by the Staff and not previously addressed are approved. All other adjustments inconsistent with the adjustments in this Order are denied. General, state, and federal taxes are adjusted to reflect the adjustments approved by the Commission in this Order.

The Commission has previously discussed the differences between the Company, the Staff and other parties in their respective rate base computations. It is the opinion of the Commission that the South Carolina intrastate rate base at December 31, 1994, as adjusted, of $961,990,593 is both reasonable and appropriate. That rate base is shown below:

TABLE A
ORIGINAL COST RATE BASE
SOUTH CAROLINA INTRASTATE OPERATIONS

DECEMBER 31, 1994

Telecommunications Plant in Service	$1,931,451,217
Accumulated Depreciation	(819,698,071)
Net Telephone Plant in Service	1,111,753,146
Telephone Plant Under Construction	10,084,237
Property Held for Future Use	-0-
Materials and Supplies	14,586,321
Cash Working Capital	10,421,341
Casualty Reserve - Net	(6,175,000)
Accumulated Deferred Income Taxes	(175,125,368)
Customers' Deposits	(3,408,846)
Advances in Aid of Construction	(145,238)
Total Rate Base	961,990,593

5. In order to provide the Company with an opportunity to earn a fair and reasonable return on its South Carolina investment, the Commission must determine what capital structure is appropriate for ratemaking purposes. The Company and the Staff propose that BellSouth Telecommunications, Inc.'s regulated capital structure and debt cost rates be utilized in this proceeding. The Company and Staff both propose viewing the capital structure and embedded cost rates of BellSouth at March 31, 1995, although Staff proposes an adjustment for refinancing costs. The Consumer Advocate and SCCTA originally proposed a hypothetical capital structure of 60%

equity and 40% debt, while using the embedded cost rate at April 30, 1995 in prefiled testimony. In the summary of his testimony, witness Legler modified his position somewhat by stating that he had made calculations for the weighted cost of capital two ways, one using actual capital structure ratios and the other using a capital structure consisting of 40 percent debt and 60 percent common equity. Dr. Legler also, in his summary, modified his position as to the cost of debt, and adopted the Company's original rate of 7.43 percent. Tr., Vol. 1, Legler at 100-101.

The Commission concludes that the regulated capital structure and debt cost rates of BellSouth Telecommunications, Inc. at March 31, 1995, provide the most useful proxy for BellSouth's South Carolina operations in this proceeding. The Commission further finds that the capital structure should be adjusted to reflect the Commission's ruling on refinancing costs. This Commission has always been somewhat hesitant to use a hypothetical capital structure, preferring, if possible, to use actual percentages of long term debt and common equity. We believe also in the present case that the use of the actual percentages for debt and equity are preferable and more accurate than use of the hypothetical capital structure.

Using the March 31, 1995 figures, the Company's capital structure consists of long term debt and common equity. The embedded cost rate for long term debt is 7.47%, as finally proposed by the Staff.

6. One of the principal issues in any ratemaking

determination involves the proper earnings to be allowed on the common equity investment of the regulated utility. In this proceeding, the Commission was offered the expert testimony of witnesses relating to the fair and reasonable rate of return on common equity for the Company. These financial experts presented detailed explanations of a number of methodological approaches to the determination of the cost of equity capital.

The Commission's analysis of the evidence regarding the appropriate return on equity in this case must be guided by the constitutional principles set forth by the Supreme Court of the United States in Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, supra., and Federal Power Commission v. Hope Natural Gas Company, supra. These tests can be summarized as follows:

1. The allowed return on common equity should be the same as that earned on other investments of comparable risk.

2. The allowed return should be sufficient to maintain the utility's credit standing and enable it to raise necessary capital.

3. A reasonable return may vary over time reflecting changing economic conditions.

While the Commission adheres to no particular theory or methodology for the determination of a fair rate of return on common equity, it does test the various recommendations before it against these constitutional standards to determine the reasonableness of the approaches proposed by the various parties. With these legal standards in mind, the Commission is able to fulfill its function of engaging in a careful analysis of the economic and financial theories before it for application within a regulatory context.

The Commission heard the testimony of three witnesses on return on equity. Dr. Randall S. Billingsley, Associate Professor of Finance at Virginia Polytechnic Institute and State University, testified on behalf of Southern Bell. Dr. John B. Legler, Professor of Banking and Finance at the University of Georgia, appeared on behalf of the Consumer Advocate and the SCCTA. Dr. James E. Spearman, Assistant Public Utilities Economist, testified on behalf of the Staff.

Dr. Billingsley applied a Discounted Cash Flow analysis, a Capital Asset Pricing Model ("CAPM") analysis and a Yield Plus Risk Premium analysis to determine the appropriate return on equity. Dr. Billingsley recommended a range for the return on equity of 13.71% to 13.95%, with a midpoint of 13.83%, which included a flotation cost adjustment. In rebuttal testimony, he analyzed the Regional Bell Holding Companies ("RBHC") and Dr. Legler's independent telephone company comparison group, using his DCF and CAPM methodologies and IBES and Zacks earnings growth, and calculated that the cost of equity would lie between 12.23% and 15.00%, with a midpoint of 13.62%. Tr., Vol. 4, Billingsley at 133.

Dr. Legler utilized a Discounted Cash Flow analysis, a Risk Premium analysis, and a Capital Asset Pricing Model analysis. Dr. Legler recommended a return on equity of 11%. No flotation cost adjustment was included in his recommendation, as Dr. Legler believed such an adjustment to be unnecessary.

Dr. Spearman applied a Discounted Cash Flow analysis and a Capital Asset Pricing Model analysis. Dr. Spearman recommended a return on equity in the range of 11.5% to 12.0%. No flotation adjustment was included, as Dr. Spearman determined that neither Southern Bell, nor its parent company has recently publicly issued common stock or intends to publicly issue stock in the next few years and, therefore, a flotation cost adjustment would be inappropriate.

The Commission notes that the differences in the results of the testing are largely based on the comparison or proxy groups chosen to complete the testing. Dr. Spearman chose BellSouth's parent Company and the other RBHC's for the group. Dr. Legler's comparison group also comprises only telephone companies. Dr. Billingsley chose 20 of 347 possible firms for his analysis, not all of which were utility and/or regulated companies. On rebuttal, however, Dr. Billingsley analyzed a group of RBHCs and independent telephone companies, using his methodology, and came up with a slightly lower result than in his first analysis.

Based on the evidence presented by the witnesses and current economic conditions, the Commission adopts a 12.75% return on common equity as appropriate for the setting of rates for Southern Bell. The Commission also determines that no flotation cost adjustment is warranted at this time. A 12.75% return falls within the overall recommended range established for the rate of return on equity in this case. The low end of the range as delineated by Dr. Legler is 10.40%, and the high end as delineated in Dr. Billingsley's direct testimony is 13.95% or 15.00% as delineated in his rebuttal testimony. We disagree with Dr. Billingsley's assertions that Dr. Legler's and Dr. Spearman's surrogates are inappropriate, and hold, in this case, that telecommunications companies are a better comparison group with BellSouth than the various non-utility surrogates favored by Dr. Billingsley. The analyses performed by both Dr. Legler and Dr. Spearman produce estimated returns on equity as high as 14.33%. Dr. Legler's calculated return on equity ranges from 8.35% to 14.33%. Dr. Spearman's calculated return on equity ranges from a low of 6.55% to a high of 13.42%. Although both witnesses recommend a return on equity below 12.75%, the Commission holds that the analyses based on telecommunications company comparison groups support a 12.75% cost of equity, and that 12.75% is the appropriate cost of equity for this Company.

The Commission considers the value of 12.75% to represent a reasonable expectation for the equity owner, and, therefore, consistent with the standards in the Hope decision. A rate of return on rate base found fair and reasonable is sufficient to protect the financial integrity of the Company, to preserve the property of the investor, and to permit the Company to continue to provide reliable services to present and future customers at reasonable rates.

In arriving at a fair rate of return herein, the Commission is primarily concerned only with the return to be earned on the common equity allocated to that portion of the Company's operations subject to the Commission's jurisdiction in this proceeding. The Commission has made its findings based on the jurisdictional South Carolina intrastate operations of the Company.

An important function of ratemaking is the determination of the overall rate of return which the utility should be granted. This Commission has utilized the following definitions of "rate of return" in previous decisions, and continues to do so in this proceeding.

> For regulatory purposes, the rate of return is the amount of money earned by a regulated company, over and above operating costs, expressed as a percentage of the rate base. In other words, the rate of return includes interest on long-term debt, dividends on preferred stock, the earnings on common stock and surplus. As Garfield and Lovejoy have put it "the return is that money earned from operations which is available for distribution among the various classes of contributors of money capital. In the case of common stockholders, part of their share may be retained to surplus."
>
> Phillips, The Economics of Regulation, pp. 260-261 (1969).

The amount of revenue permitted to be earned by the Company through its rate structure depends upon the rate base and the allowed rate of return on the rate base. As previously discussed, the primary issue between the regulated utility and regulatory body most frequently involves the determination of a reasonable return on common equity, since the other components of the overall rate of return, i.e., cost of debt and appropriate capital structure, are most easily established. Although the determination of the return on common equity provides the necessary component from which the rate of return on rate base can be derived, the overall rate of return, as set by this Commission, must be fair and reasonable.

The United State Supreme Court's landmark decisions in Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, supra, also delineated general guidelines for determining the fair rate of return in utility regulation. In the Bluefield decision, the Court stated:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertaking which are attended by corresponding risk and uncertainties; but it has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business generally.
>
> 262 U.S. at 692-693.

During the subsequent year, the Supreme Court refined its appraisal of regulatory precepts. In its frequently cited Hope decision, supra, the Court restated its view:

> We held in Federal Power Commission v. Natural Pipeline Gas Co....that the Commission was not bound to the use of any single formula or combination of formulae in determining its rates. Its ratemaking function,

> moreover involves the making of 'pragmatic adjustments' (citation omitted)....Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling (Citations omitted)....
>
> The ratemaking process under the Act, i.e., the fixing of 'just and reasonable' rates involves a balancing of the investor and the consumer interests. Thus we stated in the Natural Gas Pipeline Co. case, that regulation does not insure that the business shall produce net revenues. (Citations omitted).
>
> But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it it important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. (Citation omitted). By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.
>
> 320 U.S. at 602-603.

The vitality of these decisions has not been eroded, as indicated by the language of the more recent decision of the Supreme Court in IN RE: Permian Basin Area Rate Cases, 390 U.S. 747 (1968). This Commission has consistently operated within the guidelines set forth in the Hope decision.

The Commission has found that the capitalization ratios as of March 31, 1995, as adjusted, are appropriate and should be used in the instant proceeding. The Commission has likewise found that the respective embedded cost rates for long-term debt of 7.47% should be utilized in the determination of a fair rate of return. For the purposes of this proceeding, the Commission finds the proper cost rate for the Company's common equity capital to be 12.75%.

Using these findings, the overall rate of return on rate base for the Company's South Carolina intrastate operations may be derived as computed in the following Table:

TABLE B
OVERALL RATE OF RETURN

	RATIO %	COST %	WEIGHTED COST %
Long Term Debt	35.82	7.47	2.68
Common Equity	64.18	12.75	8.18
	100.00		10.86

7. The Commission concludes that the Company's current net income, after accounting and pro forma adjustments approved herein, is $104,461.626 as shown on Table C below:

TABLE C
CURRENT NET INCOME
AFTER ADJUSTMENTS

Rate base	Embedded Cost	Overall Cost/Rate	Net Income
$344,548,767	7.47%	2.68%	$25,737,793
$617,441,826	12.75%	8.18%	$78,723,833
$961,990,593		10.86%	$104,461,626

The Commission finds that, in order to have the opportunity to earn the 12.75% return on equity approved herein, Southern Bell's revenues should be lowered to $638,354,521, thereby reducing its net operating income to $104,461,626. *See* Table D.

TABLE D
NET OPERATING INCOME FOR RETURN
AFTER RATE DECREASE

Operating Revenues	$638,354,521
Operating Expenses	537,083,697
Net Operating Income	$101,270,824
Interest During Construction	264,075
Customer Growth	2,926,727
Net Operating Income for Return	$104,461,626

Consequently, after examination of the overall subject of Southern Bell's earnings for 1994, the Commission has determined that rates should be reduced prospectively to Southern Bell's consumers in the amount of $42,262,763 effective on the date of this Order, except as to number 3 below and the local rate reductions as stated below. The Commission has considered each party's proposal regarding the method in which reductions should be implemented. The Commission concludes that rate reductions on a prospective basis are to be made in the following manner:

1. Reduce current hunting charge rates from the existing rate to $12 per month.
2. Modify tariff language to base hunting charges on the number of required rotations.
3. Reduce intrastate access charges by $12 million in areas deemed appropriate by BellSouth. Interexchange carriers are hereby required to flow through these access reductions to their customers. Interexchange carriers are hereby required to submit a plan (and serve it on other

parties) to accomplish this for approval, said Plan to include no further deaveraging of toll rates. This must be done within ten (10) days of receipt of this Order. Other parties will then have ten (10) days to comment. The Commission will then issue a final Order on this Plan.

4. Reduce South Carolina intraLATA toll rates by $5 million.

5. Reduce the non-recurring charge associated with DID from $915 to $50. Also, reduce the monthly termination rate associated with DID from $40 to $30.

6. Reduce the current monthly charge for PBX from the current rate to 1 1/2 times the 1 Party Business Rate.

The balance of the rate reduction, consisting of $8,163,763, is to be used to reduce existing local rates under a proposed plan that must be filed by BellSouth within (10) days of the Company's receipt of this Order. BellSouth shall serve this Plan on the other parties to this case at the same time as it is filed with the Commission, and other parties may respond to Southern Bell's proposal, and file their responses with the Commission and serve all other parties within ten (10) days of their receipt of the Company's Plan. The Commission will consider the Plan and all comments and make a final ruling with regard to the Plan.

It should be noted that Area Plus reductions should not be included in BellSouth's Plan to be filed for approval.

CONCLUSIONS OF LAW

1. BellSouth Telecommunications, Inc. is a corporation authorized to conduct a public utility business in the State of South Carolina.

2. The Company's present rates and charges were approved by Order No. 94-1229, dated December 5, 1994, in Docket No. 93-503-C.

3. The Company owns and operates exchanges and lines providing local exchange and intraLATA toll telephone service to access lines located throughout South Carolina.

4. The review period for this investigation is the twelve months ending December 31, 1994.

5. The appropriate operating revenues for the Company for the review period under its present rates and after accounting and pro forma adjustments are $638,354,521.

6. The appropriate operating expenses for the Company's intrastate telephone operations for the review period under its present rates and after accounting and pro forma adjustments are $537,083,697.

7. The Company's appropriate level of net operating income for return after accounting and pro forma adjustments is $104,461,626.

8. A year-end original cost, South Carolina intrastate rate base of $961,990,593 consisting of the components set forth in Table B of this Order, should be adopted.

9. The capital structure utilized by the Commission in this

proceeding for its determination of the Company's proper level of return on common equity is the BellSouth Telecommunications, Inc. capital structure as of March 31, 1995.

10. That Staff's embedded cost rates for long-term debt of 7.47% as of March 31, 1995 should be used in the determination of a fair, overall rate of return.

11. The reasonable rate of return on common equity that the Company should be allowed to earn is 12.75% which is adopted by the Commission for this proceeding. Combined with the debt and the capital structure set forth above, the Commission finds the reasonable, overall rate of return is 10.86%

12. Based on a review of the Company's appropriate operating revenues, expenses, and net operating income for return after accounting, pro forma adjustments, capital structure, and rate of return on common equity established herein, Southern Bell's rates should be reduced prospectively by the amount of $42,262,763. The rate reduction shall be effective with the date of this Order (except as to local rate reductions) and be made in the manner as set forth by this Order. Southern Bell shall provide a Plan to reduce local rates by the remaining balance of the rate reduction in accordance with the schedule set forth in this Order. Interexchange carriers shall provide a plan to flow through access charge reductions to their customers.

13. The Company shall have ten days from the receipt of this Order to provide tariffs reflecting the matters contained herein.

14. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Rudolph Mitchell
Chairman

ATTEST:

Gary E Walsh
Deputy Executive Director

(SEAL)

Commissioner Warren D. Arthur, IV, dissenting:

I believe that a rate of return on equity of 12.75% is very excessive. I feel that the rate of return on equity should not exceed 12.00%, which is the high end of the range as presented by the Commission Staff and which is 40 basis points higher than what was recommended by the Consumer Advocate. All the cost of equity witnesses utilized proxy groups of companies in the analyses of the cost of equity. The Commission Staff's proxy group and the Consumer Advocate's proxy group both utilized telephone companies for their proxy groups. The witness for BellSouth utilized a vastly different proxy group which included companies that are not all utility or regulated companies. Based on the proxy groups used, I feel that more deference should be given to the testimony of the Commission Staff witness and the Consumer Advocate witness.

Furthermore, I believe that the trend in long-term interest rates over the last year has clearly shown downward pressures which indicate that a lower cost of equity is appropriate. Interest rates are an important factor in determining the appropriate rate of return on equity. Generally, interest rates and the cost of equity move in the same direction, and using a Capital Asset Pricing Model with a constant risk premium, a one to one correlation exists between interest rates and the resulting cost of equity. The Commission approved a 13.00% return on equity for BellSouth in Order No. 94-1229, dated December 5, 1994, Docket No. 93-503-C. On November 30, 1994, the yield on 30-year Treasury bonds was 8.00%. At the time of this hearing in September 1995, the yield on 30-year Treasury bonds was approximately 6.50%. On December 27, 1995, the yield on the 30-year Treasury bond was approximately 6.00%. Thus, long-term interest rates have declined by approximately 200 basis points since the previously approved return on equity of 13.00%. A reduction in the approved return on equity of 25 basis points to 12.75% virtually ignores the large reduction in the long-term interest rates and its corresponding impact on the return on equity required by investors. I believe that this downward trend in interest rates clearly indicates a much larger reduction in the allowed rate of return on equity than the majority approved 12.75%.

Regarding the reduction of rates as approved by the majority, I personally believe that the reduction is too heavily weighted toward business customers. I believe that we must work with BellSouth to protect the residential consumers as best we can, and I am very concerned that cutting business rates too much up front will result in more and more pressure on the residential customer. We must be cognizant of the negative pressures of competition and try to protect the residential customers in South Carolina from the negative effects of competition. The majority's decision has eliminated profits which were used to subsidize local rates. The elimination of these profits could likely result in higher rates for residential customers in the not too distant future.

Also, I would like to state that I am deeply concerned in the trend of the Commission of almost ignoring the Commission Staff witnesses and the Consumer Advocate witnesses in its considerations of recent cases.

Respectfully submitted,

Warren D. Arthur, IV
Commissioner, Sixth District